INDEX

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	4

AUTHORITIES CITED

Edwards v. *Douglas*, 269 U. S. 204	5
Revenue Act of 1916, Sec. 31(b) (added by Sec. 1211 of the War Revenue Act of 1917, c. 63, 40 Stat. 300, 308)	2
Judicial Code, Sec. 240(a), as amended by the Act of February 13, 1925, c. 129, 43 Stat. 936	2

26840—27

In the Supreme Court of the United States

OCTOBER TERM, 1926

No. 770

F. H. MASON, PETITIONER

v.

C. F. ROUTZAHN, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court (R. 22) is reported in 8 F. (2d) 56, and that of the Circuit Court of Appeals (R. 38) in 13 F. (2d) 702.

JURISDICTION

The judgment sought to be reviewed was entered on June 30, 1926. (R. 37.) A petition for rehearing was entertained and was denied on October 7, 1926. (R. 57.) Jurisdiction to grant the writ prayed for is conferred upon this Court by Section

240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

STATEMENT

This suit was brought to recover income taxes paid on certain corporate dividends received by petitioner from The B. F. Goodrich Co. during 1917 and included in his return of income for that year. The dispute is over the rate at which such income was taxable. The statute to be applied is Section 31(b) of the Revenue Act of 1916 (added by Section 1211 of the War Revenue Act of 1917, c. 63, 40 Stat. 300, 338), which is as follows:

> (b) Any distribution made to the shareholders or members of a corporation, joint-stock company, or association, or insurance company, in the year nineteen hundred and seventeen, or subsequent tax years, shall be deemed to have been made from the most recently accumulated undivided profits or surplus, and shall constitute a part of the annual income of the distributee for the year in which received, and shall be taxed to the distributee at the rates prescribed by law for the years in which such profits or surplus were accumulated by the corporation, joint-stock company, association, or insurance company, etc.

The case was tried on a stipulation of facts (R. 7) which in some respects is inadequate. The dividends received by petitioner were as follows (R. 3, 8):

ON COMMON STOCK

Date of declaration	Date of payment	Received by Mason
October 25, 1916	February 15, 1917	$22, 781. 00
January 24, 1917	May 15, 1917	22, 781. 00

ON PREFERRED STOCK

October 25, 1916	January 2, 1917	$17, 517. 50
January 24, 1917	April 2, 1917	17, 473. 75
January 24, 1917	July 2, 1917	17, 473. 75

The stipulation does not show whether the dividend resolutions directed that the dividends should be payable to the stockholders of record at the dates of the declarations, or at some later dates. These dividends were included by the petitioner in his income tax return for the year 1917 (R. 3), and reported by him as paid from surplus accumulated by the corporation during 1916, and he paid a tax thereon at the rates prescribed by law for 1916.

Thereafter the Commissioner of Internal Revenue levied an additional tax on the theory that the distributions of the dividends were made when the dividends were paid in 1917, not when they were declared, and that at the respective dates of payment there were net earnings accumulated during 1917 sufficient to pay the dividends, which were therefore presumed to be paid out of 1917 earnings and taxable at the 1917 rate, which was higher than for 1916.

The stipulation shows that at the close of the year 1917, taking the year's business as a whole,

the books of the corporation disclosed net earnings for 1917 in more than the amount of the dividends paid in 1917. (R. 12.) It also appears that agreements were made by the B. F. Goodrich Co. with dealers in its tires under which the bulk of the tires made between January 1 and July 1, 1917, were sent to dealers, and which provided that the dealers might return, under certain conditions, during September and October, 1917, tires they were unable to sell. (R. 9 et seq.) It was stipulated that if these contracts did not amount to "firm sales," the company had no actual profits earned in 1917 prior to the date of dividend payments, and that all of its profits for 1917 were actually earned after the dividend payments. (R. 15.) Notwithstanding statements in the opinion of the trial court to the contrary (R. 23), there is nothing in the record to show that at the time the dividends were declared the corporation attempted to specify that the dividends were to be paid out of earnings for any particular year. An announcement that they were so paid was first made January 28, 1918, in a letter to the stockholders. (R. 13.)

ARGUMENT

It may fairly be claimed that the stipulation of facts in substance shows that there were no actual net earnings in 1917 prior to the dates the dividends were paid. Accepting the theory of the Collector that the date of payment and not the

date of declaration of a dividend is the date of distribution within the meaning of Section 31(b), in order to establish that there were 1917 earnings available when the dividends were paid and that the distributions were made out of 1917 earnings, it is necessary to adopt the theory that the earnings for the year disclosed at the end of the year must be treated as a unit and a pro rata share of them assumed to be earned during each month of the year.

After that point is disposed of favorably to the Collector, the question then arises whether a distribution is made, within the meaning of the statute, when a dividend is declared or when it is paid. This is important, since a distribution scarcely may be made out of earnings subsequently accumulated.

While *Edwards* v. *Douglas*, 269 U. S. 204, settled the point that the most recently accumulated undivided profits or surplus may be those of the current year, and not alone those accumulated at the close of the preceding fiscal year, we do not see that either of the questions above stated was necessarily involved or decided. That case dealt with two dividends paid in September and December, 1917. While the opinion does not mention it, the record in that case (pp. 32, 33) shows that one dividend was declared September 13, to be paid September 28 to stockholders of record September 24, 1917. The other was declared December 13, to be paid December 28 to stockholders of record on December 18,

1917. Since so short a time elapsed between declaration and payment, and both events occurred in the same year, the question whether date of declaration or date of payment should be considered the date of "distribution" was not important and was not presented or considered. The opinion speaks of the date of payment as the date of distribution, but under the circumstances no special significance can be attached to the words used.

The other point, as to whether there must be actual earnings for the current year at the date of the distribution or whether the earnings for the year as a whole may be taken as a basis and prorated for the purpose of ascertaining current earnings available for distribution at date of distribution, *Edwards* v. *Douglas* does not settle. The opinion, while referring to the fact that the District Court, in determining the 1917 earnings for the fraction of a year prior to the dividend payment, prorated the entire year's profits, pointed out that it was not suggested that the actual accrued earnings for that part of the year 1917 prior to the dividend dates, were not sufficient to pay the dividends. There is a statement in the opinion that the fiscal year must be treated as a unit. On the case as disclosed, that decision may be authority for the proposition that a pro rata share of the entire year's earnings may be treated as approximating the actual earnings for a fraction of the year, in the absence of proof that there were no earnings actually accumulated during the fractional period.

It falls short of being authority for the rule that the unit and prorating method may be used where it affirmatively appears, as may be claimed here, that no earnings were actually accumulated for the year until after the distributions were made. We are obliged to concede that the two questions are open and debatable.

There is one feature of this case that seems to have so far escaped attention. Two of the dividends were declared in 1916. If the petitioner and District Court are right in concluding that the distribution is made, within the meaning of Section 31(b) of the Revenue Act of 1916, when the dividend is *declared,* then these two distributions were made in 1916. Section 31(b), providing for application of the tax rate for the year in which the corporate earnings were accumulated, only relates to distributions made "in the year 1917, or subsequent tax years." It would follow that if the dividends declared in 1916 are considered distributions made in 1916, as petitioner asserts, Section 31(b) has no application, and there is no statute applicable to those two distributions changing the ordinary rule that the rate of taxation is that for the year for which the return is made.

On the theory that the distribution of the two dividends was made in 1916 and the amount thereof passed to the credit of the stockholder when declared, the amount was *accrued* income to the stockholder when declared in 1916, but *received* income when paid in 1917.

If he made his returns on a receipts and disbursements basis (as he seems to have done), he was required to include in his 1917 return for taxation at the 1917 rate the two dividends declared in 1916. This produces the incongruous result that although the distributions are said to be made in 1916, when the two dividends were declared, nevertheless they were not received for tax purposes until paid in 1917.

Carrying this to its logical conclusion, a dividend declared in 1916 and paid in 1917 if returned on a receipts and disbursements basis, would take the 1917 rate; while a dividend declared in 1917 and paid on the same date in 1917 as the other, would take the 1916 rate, if there were no 1917 earnings, or if the 1917 earnings were actually earned after the dividend payments and the method of prorating the entire year's earnings is rejected. This seems to indicate something wrong with petitioner's theory that declaration is distribution as the latter word is used in this section of the statute, and that the Circuit Court of Appeals may be right in the conclusion that within the meaning of the word as used in Section 31(b) a distribution means a payment of a dividend. This confirms the impression that there is room for discussion on the questions here presented.

The Treasury Department advises that a number of cases are pending in the courts presenting the same questions, and that notwithstanding that Section 31(b) was not reenacted in later revenue

acts, a very large number of cases involving these points are not finally closed by settlement or the statute of limitations.

For these reasons the United States does not oppose the issuance of the writ.

Respectfully submitted.

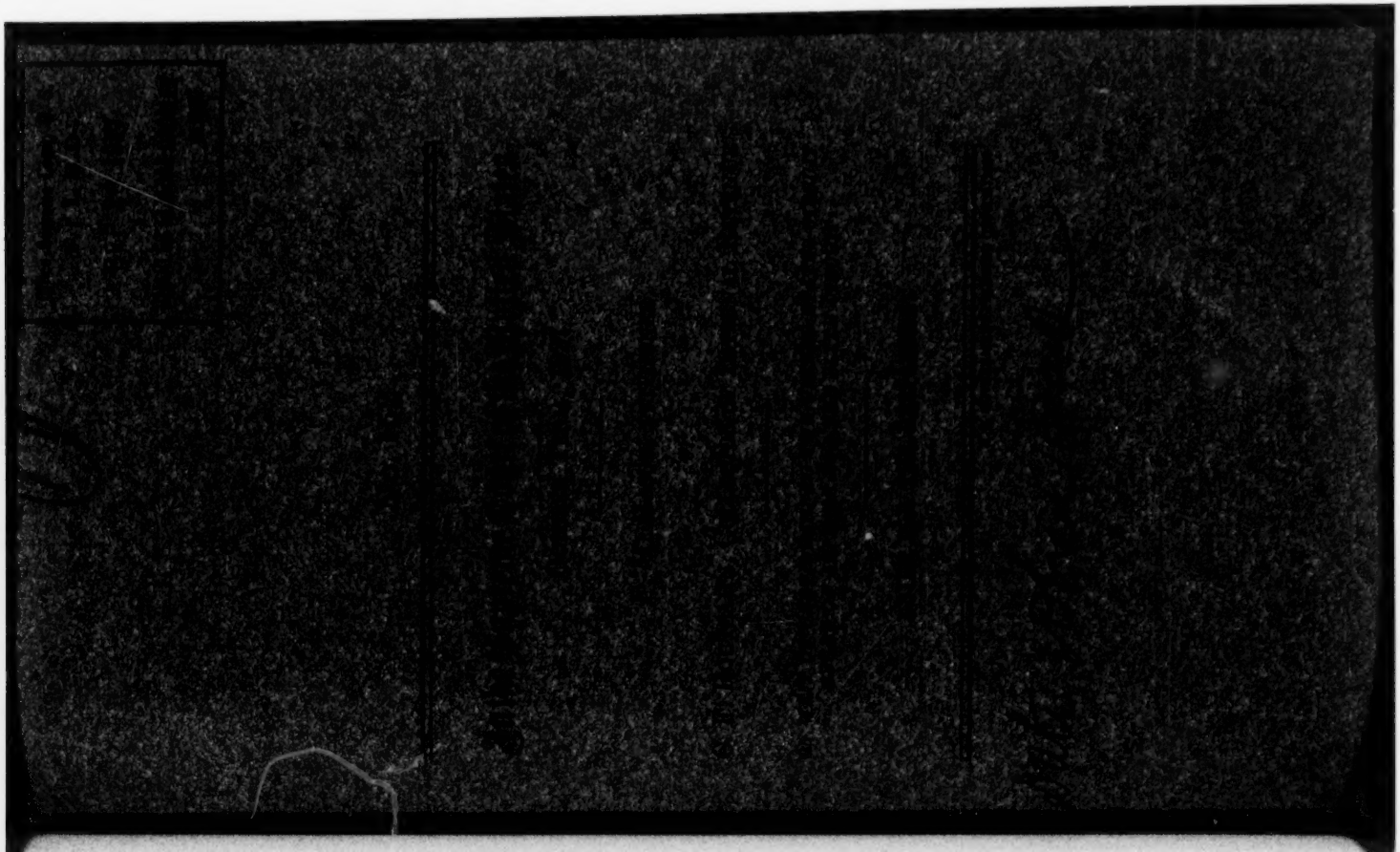
WILLIAM D. MITCHELL,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

K. L. CAMPBELL,
Attorney.

JANUARY, 1927.

○



INDEX

	Page
Opinions below	1
Jurisdiction	1
The questions	2
The statute	2
Statement	4
Summary of argument	6
Argument:	
I. The dividends paid in 1917 should not be treated as paid out of 1917 earnings if it appears that, in fact, at the date of payment there were no current earnings, notwithstanding that before the close of the year there were sufficient earnings to pay such dividends	8
II. Accepting the collector's view that the date of the distribution referred to in the statute is the date of payment and not the date of declaration of the dividend, there were no 1917 earnings available on the dates of distribution	14
III. A distribution was made within the meaning of the statute not when the resolution was passed declaring the dividend but when payment was made to the stockholders	16
Conclusion	27

CITATIONS

Cases:	
Edwards v. *Douglas*, 269 U. S. 204	6, 8, 16
Stange, A. H., 1 B. T. A. 810	22, 23
Statutes, etc.:	
Revenue Act of 1916, Sec. 31, added by Sec. 1211 of Revenue Act of 1917, c. 63, 40 Stat. 300, 336–338	2
Revenue Act of 1918, c. 18, Sec. 201(e), 40 Stat. 1057, 1060	12, 13
Treasury Regulation No. 33, Art. 107, January 2, 1918	11
Thompson on Corporations (3d ed.), Vol. 7, Sec. 5276	19
New York Stock Corporation Law, Sec. 58	20